

DEPARTMENT OF FINANCE
MCCOMBS SCHOOL OF BUSINESS
UNIVERSITY OF TEXAS AT AUSTIN

Finance 397.1 - Investment Theory and Practice

Spring 2012

Tuesday & Thursday 2:00 – 3:15, UTC 1.104, unique #03375

Professor: Shimon Kogan
GSB 5.159, Shimon.Kogan@austin.utexas.edu
Class website: Blackboard
Office Hours: Tuesday, 5:00 – 6:00

TA: Elliott Hendrix
TA office hours and location: posted on BlackBoard

Course Description

Finance 397.1 is an introductory survey investments course. We structure the course to study answer a deceptively simple question – how should you invest your current excess liquidity (e.g., funds contributed to retirement funds) to meet specific future liquidity needs (e.g., pay for retirement)? We start by studying how individuals choose between various types of uncertain outcomes, how they view risk, and what types of risks they are averse to. We then apply these insights to make decisions on asset allocation between generic equity indexes and cash.

Next, we ask how risks and returns vary over time and how they can be forecasted. We analyze drives these fluctuations in market conditions and show how the allocation decision between equities and cash changes over time. We study both aspects extensively covering market timing and life-cycle considerations.

We then go beyond the generic market index and ask whether there are better equity portfolios – stock portfolios that have better tradeoff between risk and return than the market index. In so doing, we discuss various quantitative strategies (size, book-to-market, momentum, etc.), show how they are constructed, and study their properties.

We then extend the portfolio composition problem by looking at other types of assets – bonds, commodities, and options. These assets are all instrumental in building a modern investment portfolio. We learn how to price these assets (one at a time) and then how to combine them with equity portfolios.

Throughout the course, we put a great deal of emphasize on the use of data to both understand patterns of returns and apply the tools we discuss. You will get an opportunity to apply

the concepts learned in class through a series of mini-cases and assignments. The course will combine lecture, discussion, guest speaker talks, and excel-based exercises.

Course Requirements and Grading

Grades will be based on the student's performance on the eight problem sets, the two non-cumulative exams, and class participation. The weights on each component of the overall course grade are as follows:

Problem Sets	ongoing	40%
Exam I	Thursday, March 1	25%
Exam II	Thursday, May 3	25%
Class Participation	ongoing	10%

Make-up and extra-credit assignments are generally not possible. Your grade will be determined solely by the components listed above. **Assignments are due at the beginning of class.** If you fail to turn an assignment when it is due, 20% penalty will be applied to its grade if submitted within 12 hours from when it is due; afterwards, the assignment will be graded.

Class Attendance, Participation, and the use of laptop computers in class

If you miss more than four classes without some form of prior approval from me, I reserve the right to drop your grade by one letter grade (e.g., an A drops to a B, an A- to a B-, etc.). If you miss more than six classes, I reserve the right to fail you so that you may take the class again when it is more convenient for you.

You cannot use your laptops in class, unless instructed otherwise; it just doesn't seem to work.

Course Materials

I will post all relevant materials on Blackboard. We do not use a textbook for this class.

Guest Speakers

Prof. Jan Schneider (teaching the other sections of the course) and I have arranged for three guest speakers to come and provide their perspective as leading practitioners on various investment related topics. Due to the logistics involved in arranging these talks, we will com-

bine sections on the days scheduled for the talks. To minimize conflict with other classes, these talks are scheduled for the late afternoon. Please take a note of these dates to ensure your attendance. **We will have question(s) on the final exam related to materials that will be covered exclusively in these talks.**

General and Miscellaneous Policies

- Prof. Jan Schneider and I will coordinate very closely in terms of the materials we cover, load, and grading policy. We further plan on cross-teaching some of the subject matters based on our research.
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- Though attendance will not be taken, you are responsible for everything covered or assigned in class. The lectures may depart from the material assigned and it is important that you review the assigned readings prior to the class session.
- Academic dishonesty will not be tolerated. Your responsibilities with regard to scholastic dishonesty are described in detail in the Policy Statement on Scholastic Dishonesty for the McCombs School of Business. In particular, it is expected that the work on your examinations will be entirely your own and that you will provide a level and quality of work on your group projects commensurate with your colleagues. Failure in these regards may result in failure on the examination, projects, or course.
- The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the Office of the Dean of Students at 471-6259.

Course Schedule and Readings

MEETING	DAY	DATE	TOPIC
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FIRST HALF

RISK PREFERENCES

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|---|-----|--------|--|
| 1 | Thu | Jan-18 | Class introduction |
| 2 | Tue | Jan-24 | How do individuals' make choices under risk? |
| 3 | Thu | Jan-26 | What else may affect choices under risk?
Habit formation, peer effects, and Prospect Theory |

THE EQUITY RISK PREMIUM

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|---|-----|--------|---|
| 4 | Tue | Jan-31 | How big is the equity risk premium? |
| 5 | Thu | Feb-2 | Does the risk premium change over time and how can we predict those changes? |
| 6 | Tue | Feb-7 | What are the rational explanations for variations in the equity risk premium? |
| 7 | Thu | Feb-9 | What is "sentiment" and does it drive equity returns? |

ASSET ALLOCATION OVER TIME

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|----|-----|--------|---|
| 8 | Tue | Feb-14 | Should our asset allocation change with investment horizon? |
| 9 | Thu | Feb-16 | How should asset allocation change with age? |
| 10 | Tue | Feb-21 | Guest Speaker Talk |
| 11 | Thu | Feb-23 | Should we hold short-term or long-term or bonds? |
| 12 | Tue | Feb-28 | How can we protect our portfolio from inflation risk? |
| 13 | Thu | Mar-1 | Exam I |

GLOBAL TRIP WEEK AND SPRING BREAK

SECOND HALF

OUTPERFORMING THE MARKET INDEX

- 14 Tue Mar-20 How can we find superior stock portfolios?
- 15 Thu Mar-22 Can we outperform the market? Size and Book-to-Market portfolios
- 16 Tue Mar-27 Can we outperform the market? Momentum
- 17 Thu Mar-29 Can we outperform the market? Beta and volatility
- 18 Tue Apr-3 **Guest Speaker Talk**

INVESTMENT VEHICLES

- 19 Thu Apr-5 What standard investment vehicles are available? Characterizing open-ended funds, closed-end funds, and ETFs
- 20 Tue Apr-10 How should we choose among similar investment vehicles?

DERIVATIVES

- 21 Thu Apr-12 What are futures and how are they priced?
- 22 Tue Apr-17 Should we invest in commodities?
- 23 Thu Apr-19 **Guest Speaker Talk**
- 24 Tue Apr-24 How can we use Options to improve our portfolio?
- 25 Thu Apr-26 How do we price options?
- 26 Tue May-1 What can option markets tell us about the prospects of equity markets? -
- 27 Thu May-3 **Exam II**